

COMMONWEALTH OF VIRGINIA  
STATE CORPORATION COMMISSION

AT RICHMOND, AUGUST 15, 2016

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PETITION OF

APPALACHIAN REGIONAL HEALTHCARE, *et al.*

CASE NO. INS-2014-00244

For review of Reciprocal of America  
and The Reciprocal Group Deputy  
Receiver's Determination of Appeal

FINAL ORDER

On November 20, 2014, came Appalachian Regional Healthcare (Proof of Claim No. 000311), *et al.*,<sup>1</sup> (collectively, "Petitioners" or "Kentucky Hospitals"), and, pursuant to the Receivership Appeal Procedure,<sup>2</sup> filed with the Clerk of the State Corporation Commission ("Commission") a Petition for Review ("Petition") contesting the Deputy Receiver's Determination of Appeal in File No. 65000-003.

In their Petition, the Kentucky Hospitals requested that the Commission reverse the Deputy Receiver's Determination of Appeal issued on October 22, 2014, denying the Petitioners'

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<sup>1</sup> In addition to Appalachian Regional Healthcare, the following entities are Petitioners in this matter: Baptist Health Madisonville f/k/a Regional Medical Center/Trover Clinic Foundation (Proof of Claim No. 000541); Baptist Health Richmond f/k/a Pattie A. Clay Regional Medical Center (Proof of Claim No. 000492); Caverna Memorial Hospital (Proof of Claim No. 000386); Clinton County Hospital (Proof of Claim No. 000392); Crittenden Health Systems (Proof of Claim No. 000403); Cumberland County Hospital (Proof of Claim No. 000407); Hardin Memorial Hospital (Proof of Claim No. 000437); Highlands Regional Medical Center (Proof of Claim No. 000442); Jane Todd Crawford Memorial Hospital (Proof of Claim No. 000453); Livingston Hospital & Healthcare Service (Proof of Claim No. 000464); Marcum & Wallace Hospital (Proof of Claim No. 000466); Marshall County Hospital (Proof of Claim No. 000469); Monroe County Medical Center (Proof of Claim No. 000482); Murray-Calloway County Hospital (Proof of Claim No. 000485); Ohio County Hospital (Proof of Claim No. 000488); Owensboro Mercy Health System (Proof of Claim No. 000491); Pineville Community Hospital (Proof of Claim No. 000496); Rockcastle County Hospital and Respiratory Care Center (Proof of Claim No. 000508); St. Claire Regional Medical Center (Proof of Claim No. 000529); St. Joseph Mt. Sterling f/k/a Gateway Regional Medical Center (Proof of Claim No. 000426); T.J. Samson Community Hospital (Proof of Claim No. 000535); Twin Lakes Regional Medical Center (Proof of Claim No. 000433); and Westlake Regional Hospital (Proof of Claim No. 000553).

<sup>2</sup> The Receivership Appeal Procedure is set forth in the Third Directive of Deputy Receiver Adopting Receivership Appeal Procedure and as amended by the Sixth Directive of Deputy Receiver Adopting Amended Receivership Appeal Procedure as authorized by the Final Order Appointing Receiver for Rehabilitation or Liquidation of Reciprocal of America and The Reciprocal Group (collectively, "ROA" and "TRG") entered on January 29, 2003, in the Circuit Court of the City of Richmond in Cause No. CH03-135.

Notice of Appeal concerning the Proof of Claims submitted for legal expenses incurred by the Petitioners in litigation in Virginia and Kentucky.

On December 12, 2014, the Commission entered its Order Docketing Case, Appointing Hearing Examiner, and Setting Date for Filing Answer. Among other things, the Commission directed the Deputy Receiver to file an answer or other responsive pleading to the Petition on or before January 9, 2015, and appointed a Hearing Examiner to conduct all further proceedings in this matter. On January 8, 2015, the Deputy Receiver filed her answer.

At a prehearing conference convened by the Hearing Examiner on March 4, 2015, the parties agreed to file a Joint Stipulation of Facts on or before April 10, 2015, and that if discovery was needed, the party seeking discovery would file a Motion for Discovery and a proposed discovery schedule on or before April 10, 2015. The parties filed several motions to modify the procedural order between April 10, 2015, and November 25, 2015. Ultimately, the Hearing Examiner issued a Ruling on December 2, 2015, in which the parties were directed to file: (i) dispositive or other pre-trial motions, including Motions for Summary Judgment, on or before December 18, 2015; (ii) responses to the dispositive or other pre-trial motions on or before January 19, 2016; and (iii) replies in support of the dispositive or other pre-trial motions on or before February 19, 2016. Thereafter, both parties filed a Motion for Summary Judgment, a Response to Motion for Summary Judgment, and a Reply to Response to Motion for Summary Judgment. The Parties agree that there are no material issues of fact genuinely in dispute.

#### Factual Background

On November 1, 1997, the Virginia Insurance Reciprocal and its successor ROA assumed, by contract ("Contracts"), the insurance coverages ("Assumed Liabilities") issued by two Kentucky group self-insurance associations: the Compensation Health Association Trust

("CHAT") and the Kentucky Hospital Association Trust ("KHAT").<sup>3</sup> Pursuant to the Contracts, ROA was required to assume responsibility for the Assumed Liabilities and to issue insurance policies to the member insureds of CHAT and KHAT.<sup>4</sup> ROA thus became directly liable as an insurer to the former CHAT and KHAT policyholders. The Contracts contained indemnification agreements ("Indemnification Agreements") which obligated ROA to indemnify CHAT, KHAT, and their member insureds for all damages arising from the Assumed Liabilities.<sup>5</sup>

On January 29, 2003, ROA was placed into receivership. On July 11, 2003, the Deputy Receiver of ROA filed with the Commission an Application for Order Authorizing the Continuation of Workers' Compensation Disability Payments for Workers' Compensation Claims Denied Coverage by State Guaranty Associations, in which ROA sought approval to continue payment of medical and recurring disability payments for workers' compensation claims assumed by ROA that were likely to be denied coverage by state guaranty associations because the businesses from which the claims were assumed were not member insurers of the state guaranty associations.<sup>6</sup> The Assumed Liabilities were among such claims.

Multiple guaranty associations asserted that CHAT and KHAT and their member insureds were not considered policyholders arising out of insurance contracts assumed by ROA.<sup>7</sup> As a result, the Commission convened Case No. INS-2003-00239 in which it sought to determine whether or not Assumed Liabilities of CHAT and KHAT and other similarly situated

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<sup>3</sup> Petition at 3-4.

<sup>4</sup> *Id.* at 4.

<sup>5</sup> *Id.*

<sup>6</sup> *Application for Order Authorizing the Continuation of Workers' Compensation Disability Payments by Reciprocal of America and The Reciprocal Group for Workers' Compensation Claims Denied Coverage by State Guaranty Associations*, Case No. INS-2003-00024.

<sup>7</sup> Petition at 6.

entities were those of policyholders pursuant to § 38.2-1509 B 1 (ii) of the Code.<sup>8</sup> The Petitioners were among those entities participating in the case.

On August 24, 2005, the Commission entered its Final Order in Case No. INS-2003-00239, in which it found that the Assumed Liabilities constituted "claims of other policyholders arising out of insurance contracts." The Final Order was appealed to the Supreme Court of Virginia, but the appeal was ultimately withdrawn.<sup>9</sup>

In addition to the litigation in Virginia, the Petitioners also engaged in litigation in Kentucky in an effort to secure guaranty fund coverage for the Assumed Liabilities. On May 27, 2003, the Kentucky Insurance Guaranty Association ("KIGA"), by letter, informed ROA that it would not cover any losses that were pending before the assumption of the Assumed Liabilities.<sup>10</sup> In response, the Petitioners filed a Petition for Declaratory Judgment in Kentucky in which they sought a declaration that the Assumed Liabilities constituted policyholder claims and that KIGA was responsible for administering and paying such claims.<sup>11</sup> Ultimately, the Kentucky Court ruled in favor of the Petitioners.<sup>12</sup>

The Petitioners state that as a result of challenges by guaranty associations as to the status and coverage of the Assumed Liabilities, the Petitioners were damaged and called upon to defend themselves in connection with and arising out of the Assumed Liabilities before the Commission, the Supreme Court of Virginia, and in a declaratory judgment action in the

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<sup>8</sup> Order dated November 12, 2003, in Case No. INS-2003-00024.

<sup>9</sup> Petition at 7.

<sup>10</sup> Exhibit 10 to Petition.

<sup>11</sup> Petition at 8.

<sup>12</sup> Petition at 11.

Franklin Circuit Court in Kentucky.<sup>13</sup> Pursuant to the terms of the Indemnification Agreements entered into between ROA, CHAT, and KHAT, which also indemnified the member-insureds of CHAT and KHAT, the Kentucky Hospitals seek damages in the amount of \$439,375.20 for legal fees related to the aforementioned litigation involving the Assumed Liabilities.<sup>14</sup>

#### Petitioners' Arguments

The Petitioners argue that they were forced to spend \$439,375.20 in legal fees defending their status as policyholders of ROA, and that pursuant to the terms of the Indemnification Agreements, ROA agreed to indemnify the Kentucky Hospitals for any damages arising out of the Assumed Liabilities. In support, the Petitioners argue that the Indemnity Agreements are valid, enforceable, unambiguous agreements and should be enforced against the parties.<sup>15</sup> The Petitioners argue that the language of the Indemnification Agreements is broad and unlimited and must be enforced against ROA regardless of any contention on the part of the Deputy Receiver concerning any pre- or post-merger obligation.<sup>16</sup> In the alternative, the Kentucky Hospitals argue that if the Indemnity Agreements are ambiguous, Virginia law mandates that the agreement must be construed against the insurer and in favor of the insureds.<sup>17</sup> The Petitioners also assert that their claims are claims of policyholders arising out of insurance contracts, and are therefore entitled to priority pursuant to § 38.2-1509 B 1 (ii) of the Code.<sup>18</sup>

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<sup>13</sup> Petition at 3.

<sup>14</sup> *Id.* at 19.

<sup>15</sup> Kentucky Hospitals' Motion for Summary Judgment at 15-20.

<sup>16</sup> Kentucky Hospitals' Reply at 1-4.

<sup>17</sup> Kentucky Hospitals' Motion for Summary Judgment at 20-21.

<sup>18</sup> *Id.* at 22.

### The Deputy Receiver's Arguments

The Deputy Receiver argues that ROA's obligation under the Indemnification Agreements is unambiguously linked to the existence of "Damages" as that term is defined in the agreements. The Deputy Receiver also argues that the definition of "Damages" is unambiguously linked to ROA's assumption of an obligation directly from CHAT and KHAT, and for the claims to be covered by the Indemnification Agreements, ROA must have assumed from CHAT and KHAT the obligation to reimburse the Kentucky Hospitals for the fees and costs that are the subject of the Petition. Consequently, the Deputy Receiver argues that ROA's indemnity obligation under the Indemnification Agreements is equivalent to the pre-merger obligations that CHAT and KHAT owed to the Petitioners and without an equivalent pre-merger obligation of CHAT and KHAT for the costs for which recovery is sought, the Petitioner's claims for indemnity must fail. Finally, the Deputy Receiver takes the position that the Petitioner's claims are an attempt to establish an ROA warranty that Kentucky Insurance Guaranty Association would provide coverage for the Assumed Liabilities, or that ROA would not become insolvent and be placed into receivership. Since the Kentucky Hospitals have admitted that no such warranty was included as part of the mergers, their claims must fail.<sup>19</sup>

### The Hearing Examiner's Report

On March 18, 2016, the Hearing Examiner issued his Report. In his Report, the Hearing Examiner found that summary judgment is appropriate in this case because there is no material fact genuinely in dispute.<sup>20</sup> The Hearing Examiner, in addressing the nature of the Indemnity Agreements, found that the Indemnity Agreements are not contracts of insurance, rather they are

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<sup>19</sup> *Id.* at 3.

<sup>20</sup> Report of Michael D. Thomas, Hearing Examiner at 10.

contracts of indemnity, and are the result of equal bargaining by CHAT, KHAT, and ROA. As such, the terms of the Indemnification Agreements must be construed equally to both parties. In addition, because the Indemnity Agreements are not contracts of insurance they are not afforded priority pursuant to § 38.2-1509 B 1 (ii) of the Code.<sup>21</sup>

The Hearing Examiner also found that the plain language of the Indemnification Agreements does not require ROA to indemnify the Kentucky Hospitals for legal fees incurred in litigating the issue of guaranty fund coverage for the Assumed Liabilities.<sup>22</sup> The Hearing Examiner states that under the plain language of the Indemnification Agreements for ROA to be liable, the "liability, expense, cost, or obligation, however, incurred or characterized" must be "assumed by [ROA] as provided for in this Agreement."<sup>23</sup> In determining what liabilities, expenses, costs or obligations were assumed by ROA when the Indemnification Agreements were executed, the Hearing Examiner noted that neither the business assumed by ROA, nor the Assumed Liabilities, included guaranty fund coverage.<sup>24</sup>

The Hearing Examiner concluded that the transfer of the Assumed Liabilities did not include an obligation to seek to establish guaranty fund coverage in the event of insolvency on the part of ROA. The Hearing Examiner therefore recommended that the Commission enter an order adopting his findings, granting the Deputy Receiver's Motion for Summary Judgment, and denying the Kentucky Hospitals Motion for Summary Judgment.<sup>25</sup>

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<sup>21</sup> *Id.* at 9.

<sup>22</sup> *Id.* at 10.

<sup>23</sup> *Id.* citing Kentucky Hospitals' Motion for Summary Judgment at Exhibit 1.

<sup>24</sup> *Id.* at 10.

<sup>25</sup> *Id.* at 11.

On April 8, 2016, the Petitioners filed their Exceptions and Comments to the Hearing Examiners Report. In their Comments, the Kentucky Hospitals argue that the unambiguous language of the Indemnification Agreements requires ROA to reimburse them for the legal fees in dispute.<sup>26</sup> The Petitioners also argue that the Hearing Examiner's ruling that the Indemnity Agreements are not insurance contracts ignores the Commission's previous finding that the Merger Agreements were insurance contracts.<sup>27</sup>

NOW THE COMMISSION, upon consideration of the record in this matter, is of the opinion that the Deputy Receiver's Motion for Summary Judgment should be granted. The plain language of the Indemnification Agreements provides that for ROA to be liable, the "liability, expense, cost, or obligation, however, incurred or characterized" must be "assumed by [ROA] as provided for in this Agreement." At no time were CHAT and KHAT members of Kentucky Insurance Guaranty Association. As a result, there was no guaranty fund coverage for the insurance coverage that they offered to their member hospitals. Thus, if CHAT and KHAT had become insolvent, their member hospitals would not have been entitled to guaranty fund coverage.

In executing the agreements, ROA stepped into the shoes of CHAT and KHAT. The Assumed Liabilities did not have guaranty fund coverage at the time of the assumption, and the agreement did not provide for ROA to seek such coverage in the event of insolvency. The Kentucky Hospitals seek to create an obligation where none previously existed. If the parties had wanted to obligate ROA to seek guaranty fund coverage for the Assumed Liabilities, they were free to use clear language to effect such an assumption and liability. Rather, as argued by

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<sup>26</sup> Exceptions and Comments of Petitioners to the March 18, 2016 Report of Michael D. Thomas, Hearing Examiner at 9-12.

<sup>27</sup> *Id.* at 12-15.



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the Deputy Receiver and concluded by the Hearing Examiner, we find that the plain language of the Indemnification Agreements does not require ROA to provide indemnification for the requested legal fees.

Accordingly, IT IS ORDERED THAT:

- (1) The Deputy Receiver's Motion for Summary Judgment is hereby GRANTED.
- (2) The Kentucky Hospitals' Motion for Summary Judgment is hereby DENIED.
- (3) This case is dismissed and the papers filed for ended causes.

Commissioner Jagdmann did not participate in this matter.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission by CERTIFIED MAIL, RETURN RECEIPT REQUESTED, to: William C. Gullett, Esquire, Frost Brown Todd, LLC, The Pinnacle at Symphony Place, 150 3<sup>rd</sup> Avenue South, Suite 1900, Nashville, Tennessee 37201; Greg E. Mitchell, Esquire, Frost Brown Todd, LLC, 250 West Main Street, Suite 2800, Lexington, Kentucky 40507; Eric M. Page, Esquire, Eckert Seamans Cherin & Mellott, LLC, SunTrust Center, 919 East Main Street, Suite 1300, Richmond, Virginia 23219; Patrick H. Cantilo, Esquire, Cantilo & Bennett, L.L.P., 11401 Century Oaks Terrace, Suite 300, Austin, Texas 78758; Susan E. Salch, Esquire, Cantilo & Bennett, L.L.P., 11401 Century Oaks Terrace, Suite 300, Austin, Texas 78758; and a copy shall be delivered to the Commission's Office of General Counsel and Bureau of Insurance.